

1  
2  
3  
4

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF CALIFORNIA

5 IN RE: ONLINE DVD RENTAL  
6 ANTITRUST LITIGATION

No. M 09-2029 PJH

7 This Document Relates to:

8 Pierson v. Walmart.com USA LLC, et al.  
9 (C 09-2163 PJH)  
Levy, et al. v. Walmart.com USA LLC, et al.  
10 (C 09-2296 PJH)

**ORDER DENYING MOTION  
TO DISMISS SECOND AMENDED  
COMPLAINT**

11  
12 Defendants' motion to dismiss the second amended complaint for lack of antitrust  
13 standing came on for hearing on May 5, 2010 before this court. Plaintiffs, individuals  
14 representing a putative class comprised of subscribers to the online DVD rental service of  
15 Blockbuster, Inc. ("Blockbuster"), appeared through their class counsel, Robert G. Abrams,  
16 Peter Barile, and Guido Saveri. Defendant Netflix, Inc. ("Netflix") appeared through its  
17 counsel, Jonathan M. Jacobson and Sarah Walsh. Defendants Walmart.com USA LLC  
18 ("Walmart.com") and Wal-Mart Stores, Inc. ("Wal-Mart Stores") (collectively "Wal-Mart")  
19 appeared through their counsel, Genevieve Vose. Having read all the papers submitted  
20 and carefully considered the relevant legal authority, the court hereby DENIES defendants'  
21 motion to dismiss, as follows.

22 **BACKGROUND**

23 This is the second go-round for the plaintiff class, as they attempt to persuade the  
24 court to answer a straightforward question in their favor: whether plaintiffs, who proceed  
25 against defendants Netflix and Wal-Mart based upon artificially inflated prices that plaintiffs  
26 purportedly paid to *non-defendant Blockbuster*, have antitrust standing.

27 A. The First Motion to Dismiss

28 On December 1, 2009, the court answered this question in the negative, granting

United States District Court  
For the Northern District of California

1 defendants' earlier-filed motion to dismiss the first amended complaint, and dismissing the  
2 complaint with prejudice. See generally Dec. 1, 2009 Order Granting Motion to Dismiss  
3 ("Dismissal Order"). Plaintiffs had originally alleged that defendants Netflix and Wal-Mart  
4 had entered into an unlawful marketing agreement (the "Agreement"), with the purpose and  
5 effect of illegally dividing the markets for sales and online rentals of DVDs in the United  
6 States. Plaintiffs further alleged that, as a result of the Agreement, Wal-Mart exited the  
7 market for online DVD rentals, and Netflix was able to charge supracompetitive prices to its  
8 subscribers. See Complaint, ¶ 3. As a result, theorized plaintiffs, non-defendant  
9 Blockbuster – who was operating in a reduced two-firm market in the post-Agreement  
10 landscape – was able to meet Netflix's price and charge its own supracompetitive prices for  
11 online rental DVD programs. Id. at ¶ 6.

12 The court rejected the contention that this theory, and plaintiffs' corresponding  
13 allegations, were sufficient to confer antitrust standing, concluding that plaintiffs had failed  
14 to satisfy three of the standing factors identified in Assoc. Gen. Contractors of Cal. v. Cal.  
15 State Council of Carpenters, 459 U.S. 519 (1983) ("AGC") – directness of the injury,  
16 speculative nature of the harm, and complexity in apportioning damages. The court  
17 specifically found that plaintiffs' allegations could not establish that Blockbuster's price  
18 increase in August 2005 was directly attributable to any unlawful agreement or conduct  
19 undertaken by Netflix or Wal-Mart. The court highlighted, among other things, the following  
20 deficiencies:

- 21     • plaintiffs failed to allege that Netflix increased its *own* 3-out subscription price  
22       in conjunction with or in response to the allegedly unlawful market allocation  
   agreement;
- 23     • plaintiffs alleged that Netflix originally dropped the subscription price of its 3-  
24       out plan from \$21.99 per month to \$17.99 in October 2004 as part of its  
   response to Blockbuster's entry into the market – i.e., well *before* Netflix was  
25       alleged to have "embarked upon [its] scheme that would result in the" market  
   allocation agreement – and never raised it thereafter, making it impossible to  
26       infer that Netflix unlawfully raised its price to \$17.99 or maintained it in  
   response to the anticompetitive conduct alleged by plaintiffs, or that  
27       Blockbuster's own price increase to match Netflix's \$17.99 price in August  
   2005 was itself an anticompetitive price hike in response to the unlawful  
   agreement;

- 1 • that plaintiffs' allegations suggested that Blockbuster raised its price  
2 independently, and unilaterally, given Blockbuster's executive's statement  
3 that its \$14.99 price was "not sustainable" and given that it began testing a  
\$17.99 price in advance of the announcement of the unlawful agreement;
- 4 • and that the three month time lag between Wal-Mart's exit from the  
5 marketplace and Blockbuster's August 2005 price increase was too long to  
suggest a direct link.

6       See Dismissal Order at 10-12. The court then dismissed the complaint with  
7 prejudice, denying leave to amend on grounds that any amendment would be futile. See  
8 id. at 13.

9       On December 16, 2009, plaintiffs requested leave to seek reconsideration of the  
10 court's ruling granting dismissal, but only as to the court's dismissal with prejudice and  
11 denial of leave to amend. The plaintiffs argued that, in view of new facts learned via  
12 discovery, they could now allege a sufficiently direct and causal link between the  
13 conspiratorial conduct alleged to have been engaged in by Netflix and Wal-Mart, and  
14 Blockbuster's price increase. Plaintiffs' reconsideration arguments vowed that this new  
15 theory would no longer depend upon Wal-Mart's exit from the market, but rather on a more  
16 direct link between defendants' anticompetitive conduct and Blockbuster's eventual price  
17 increase.

18       The court granted plaintiffs' request for leave to seek reconsideration and for  
19 reconsideration itself, allowing plaintiffs to file a second amended complaint setting forth  
20 their new allegations. See Jan. 29, 2010 Order Granting Motion for Reconsideration and  
21 Leave to File Amended Complaint ("Order Granting Reconsideration") at 2-3. In so ruling,  
22 the court also noted, however, that plaintiffs "would be well-advised to pay particular  
23 attention to the legal viability of their new causation theory," and were "further reminded of  
24 the need to set forth allegations that demonstrate the directness of plaintiffs' injury with the  
25 level of particularity required under the standards previously noted and relied on by this  
26 court." See Order Granting Reconsideration at 3.

27 B.      The Second Amended Complaint and Instant Motion to Dismiss  
28

1 Plaintiffs filed the second amended complaint ("SAC") on March 30, 2010. In it,  
2 plaintiffs allege several purportedly new facts in support of a further evolved theory linking  
3 Blockbuster's price increase to defendants' allegedly anticompetitive conduct. This revised  
4 theory notwithstanding, defendants once again move to dismiss the amended complaint,  
5 for lack of antitrust standing.

6 **DISCUSSION**

7 A. Legal Standard

8 The applicable legal standard is well-established. A motion to dismiss under Rule  
9 12(b)(6) tests for the legal sufficiency of the claims alleged in the complaint. Ileto v. Glock,  
10 Inc., 349 F.3d 1191, 1199-1200 (9th Cir. 2003). Review is limited to the contents of the  
11 complaint. Allarcom Pay Television, Ltd. v. Gen. Instrument Corp., 69 F.3d 381, 385 (9th  
12 Cir. 1995). To survive a motion to dismiss for failure to state a claim, a complaint generally  
13 must satisfy only the minimal notice pleading requirements of Federal Rule of Civil  
14 Procedure 8.

15 Rule 8(a)(2) requires only that the complaint include a "short and plain statement of  
16 the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). Specific  
17 facts are unnecessary – the statement need only give the defendant "fair notice of the claim  
18 and the grounds upon which it rests. Erickson v. Pardus, 551 U.S. 89, 93 (citing Bell  
19 Atlantic Corp. v. Twombly, 550 U.S. 544, 555 (2007)). All allegations of material fact are  
20 taken as true. Id. at 94. However, a plaintiff's obligation to provide the grounds of his  
21 entitlement to relief "requires more than labels and conclusions, and a formulaic recitation  
22 of the elements of a cause of action will not do." Twombly, 550 U.S. at 555 (citations and  
23 quotations omitted). Rather, the allegations in the complaint "must be enough to raise a  
24 right to relief above the speculative level. Id.

25 A motion to dismiss should be granted if the complaint does not proffer enough facts  
26 to state a claim for relief that is plausible on its face. See id. at 558-59. "[W]here the well-  
27 pleaded facts do not permit the court to infer more than the mere possibility of misconduct,  
28

1 the complaint has alleged-but it has not show[n] that the pleader is entitled to relief.

2 Ashcroft v. Iqbal, \_\_ U.S. \_\_, 129 S.Ct. 1937, 1950 (2009).

3 In addition, when resolving a motion to dismiss for failure to state a claim, the court  
4 may not generally consider materials outside the pleadings. Lee v. City of Los Angeles,  
5 250 F.3d 668, 688 (9th Cir. 2001). There are several exceptions to this rule. The court  
6 may consider a matter that is properly the subject of judicial notice, such as matters of  
7 public record. Id. at 689; see also Mack v. South Bay Beer Distributors, Inc., 798 F.2d  
8 1279, 1282 (9th Cir. 1986) (on a motion to dismiss, a court may properly look beyond the  
9 complaint to matters of public record and doing so does not convert a Rule 12(b)(6) motion  
10 to one for summary judgment). Additionally, the court may consider exhibits attached to  
11 the complaint, see Hal Roach Studios, Inc. V. Richard Feiner & Co., Inc., 896 F.2d 1542,  
12 1555 n.19 (9th Cir. 1989), and documents referenced by the complaint and accepted by all  
13 parties as authentic. See Van Buskirk v. Cable News Network, Inc., 284 F.3d 977, 980 (9th  
14 Cir. 2002).

15 B. Plaintiffs' Newly Revised Allegations

16 Plaintiffs' challenge, via the SAC, is to overcome previously identified hurdles to the  
17 successful establishment of antitrust standing. Defendants contend that the SAC continues  
18 to suffer from the same fundamental deficiency – i.e., the lack of any direct causal link  
19 between plaintiffs' injuries and defendants' conduct – that originally led the court to dismiss  
20 the first amended complaint. Plaintiffs, however, rely on their newly revised allegations to  
21 set forth an amended theory of conduct, injury, and causation that purports to address  
22 previously noted deficiencies and satisfy AGC requirements. That amended theory can  
23 generally be stated in two parts: (1) that Netflix's anticompetitive conduct, beginning as  
24 early as October 2004 and culminating in the May 19, 2005 Agreement, evidenced Netflix's  
25 conscious decision to pursue anticompetitive conduct and engage in artificial price  
26 maintenance instead of competing in the relevant market and inevitably lowering its price;  
27 and (2) that Blockbuster's prices were tied to Netflix's prices, and would have

**United States District Court**  
For the Northern District of California

1 consequentially been lower in the fall of 2005, in the absence of Netflix and Wal-Mart's  
2 anticompetitive conduct and Netflix's unlawful price maintenance.

3 In support of this theory, and their conclusion that antitrust injury has now been  
4 successfully alleged, plaintiffs' SAC now includes, among others, the following purportedly  
5 "new" allegations:

- 6 • that, after Blockbuster entered the online DVD market with a price of \$19.99  
7 and Netflix announced the lowering of its three-out plan from \$21.99 per  
month to \$17.99 on October 14, 2004, Netflix's stock price took a big drop,  
and Netflix attributed the price reduction to competition;
- 8 • that on October 15, 2004, after Blockbuster again signaled its intent to beat  
9 Netflix on price by lowering its price to \$17.49, Netflix was motivated to begin  
anti-competitive discussions, and on October 17, 2004, sought Wal-Mart's  
10 CEO John Flemings out, in order to discuss an "alliance;"
- 11 • that despite Netflix's initial pressure, no alliance was reached, and Wal-Mart  
12 instead kept up the competitive pressure and lowered its prices in November  
2004 to below that of Netflix and Blockbuster, causing Blockbuster to lower its  
13 price to \$14.99 in December 2004;
- 14 • that during the whole of these price wars in 2004, Netflix avoided lowering its  
prices because it was consciously pursuing a different strategy – that of  
15 getting Wal-Mart to exit the marketplace;
- 16 • that ultimately, Netflix succeeded, and it reached a handshake deal with Wal-  
Mart pursuant to which Wal-Mart would exit the market on March 17, 2005,  
which agreement was publicly announced on May 19, 2005;
- 17 • that news of the deal between Netflix and Wal-Mart leaked and appeared to  
be known among the investment community in the days leading up to the  
18 announcement of the promotion agreement;
- 19 • that, had Netflix competed legally in the market throughout this whole time  
period, it would have been forced to lower its prices below \$17.99, and  
further, that Netflix's ability to lower its prices is made obvious by the fact that  
its cost per subscriber for a three-out plan was approximately \$11;
- 20 • that Blockbuster always priced at or below Netflix's prices, and made clear  
that it intended to compete with Netflix on price;
- 21 • that once Blockbuster was in a two-firm market, it was content merely to  
match Netflix's prices; and
- 22 • that Blockbuster decided to raise its price from \$14.99 by early July 2005,  
three weeks after Wal-Mart's exit;

1        See SAC, ¶¶ 59, 62-66, 68-69, 70, 83-84, 79, 91, 93, 102, 109, 113-14, 117-18.<sup>1</sup>

2        At first blush, plaintiffs' revised allegations appear to present a point by point rebuttal  
 3 to several of the deficiencies highlighted by the court in its previous order. The revised  
 4 allegations no longer allege, for example, that Netflix's \$17.99 price was set independently  
 5 and in advance of defendants' anticompetitive conduct, but now state that the \$17.99 price  
 6 was instead an artificially maintained price, following Netflix's decision to pursue  
 7 anticompetitive conduct. Similarly, plaintiffs no longer concede Blockbuster's early and  
 8 independent decision to test a \$17.99 price *before* the May 19, 2005 agreement was  
 9 announced. Instead, they allege the existence of a handshake agreement in place in  
 10 March 2005 (before Blockbuster tested its \$17.99 price); that the purportedly unlawful  
 11 agreement was leaked before it was officially announced; and that Blockbuster actually  
 12 conducted numerous price tests (thereby lessening the significance of the May 2005  
 13 \$17.99 price test). Equally significant, the amended complaint no longer reveals a three  
 14 month time lag between Wal-Mart's exit from the market, and Blockbuster's August 2005  
 15 price increase, since plaintiffs now allege that Blockbuster decided to raise prices in July  
 16 2005, just a few short weeks after Wal-Mart exited the market, and since plaintiffs further  
 17 allege that Blockbuster's immediate response to Wal-Mart's exit in June 2005 was to  
 18 increase its price to any former Wal-Mart or Netflix customers.

19       Plaintiffs' revised allegations assert a theory of causal injury that is based on a  
 20 premise that is distinct from that previously advanced: namely, Netflix's ability to convert a  
 21 competitive price into a supracompetitive price by intentionally *refusing* to compete in an  
 22 unrestrained market, while in pursuit of an anticompetitive agreement with a competitor (as  
 23 opposed to setting a supracompetitive price as the immediate consequence of an  
 24 anticompetitive agreement); and Blockbuster's reliance on Netflix pricing in setting its own  
 25 prices.

---

26  
 27       <sup>1</sup> Also new to the SAC are allegations regarding Netflix's purported efforts to keep  
 28 Amazon from entering the online DVD rental market, but these allegations are ultimately not  
 critical to the present motion. See, e.g., SAC, ¶¶ 84, 86-89.

1       The question for the court, of course, is whether plaintiffs' revised theory satisfies  
2 the three standing requirements – i.e., directness of the injury, speculative nature of the  
3 harm, and complexity in apportioning damages – that plaintiffs' prior allegations failed to  
4 fulfill. The court has struggled, these past many weeks, to arrive at a ready answer to this  
5 question.

6       In particular, the court continues to be troubled by plaintiffs' ability to allege a  
7 sufficiently direct injury. For even if the court were to conclude that plaintiffs' revised  
8 allegations satisfactorily allege the first part of plaintiffs' two-part theory – i.e., that Netflix  
9 consciously decided to forego competition in pursuit of anticompetitive conduct, thereby  
10 intentionally failing to lower its price and engaging in artificial price maintenance – it is not  
11 immediately apparent that plaintiffs have plausibly alleged that Blockbuster's prices were  
12 tied to Netflix's prices, and would have consequently been lower in the fall of 2005, in the  
13 absence of Netflix and Wal-Mart's anticompetitive conduct.

14      This is because plaintiffs' allegations continue to rest upon the fundamental premise  
15 that defendants' anticompetitive conduct – even if begun much earlier than previously  
16 thought – led to higher prices for Netflix subscribers, which in turn led to higher prices for  
17 Blockbuster subscribers. As defendants point out, this is by definition an indirect injury.  
18 Furthermore, plaintiffs have not alleged any new fact to explain precisely how or why  
19 Blockbuster's prices were increased to meet Netflix's price post-agreement, as a direct  
20 response to defendants' purportedly unlawful conduct. Rather, plaintiffs seek to fill this void  
21 with the allegations that, as a matter of basic policy, Blockbuster always met or beat  
22 Netflix's price. See Mot. Dismiss Br. at 2:4-6; SAC, ¶¶ 66, 113-14. This allegation,  
23 however, tends to suggest the unilateral exercise of Blockbuster's business judgment in  
24 consistently and voluntarily deciding to track Netflix pricing – not that Blockbuster's decision  
25 to track Netflix pricing in August 2005 was specifically motivated by defendants' unlawful  
26 conduct. And indeed, the fact that Blockbuster's practice in meeting or beating Netflix's  
27 price was in evidence *prior* to the allegedly anticompetitive conduct undertaken by Netflix,

United States District Court  
For the Northern District of California

1 tends to cut against the conclusion that Blockbuster's decision to meet Netflix's price in the  
2 fall of 2005 was somehow a direct result of Netflix and/or Walmart's anticompetitive  
3 conduct. See e.g., SAC, ¶¶ 59, 66 (alleging Blockbuster's entry into the market and  
4 immediate and subsequent attempts to undercut Netflix's price reductions).

5 Similarly, while plaintiffs newly suggest that the purportedly unlawful agreement  
6 between Netflix and Wal-Mart may have "leaked" prior to May 19, 2005, plaintiffs never  
7 directly allege that Blockbuster itself was aware of the agreement, such that the court could  
8 reasonably infer that any decision to test or increase price to match that of Netflix, would  
9 have been precipitated by the defendants' unlawful conduct. And while plaintiffs have also  
10 revised their allegations to decrease the time lag between the announcement of the May  
11 19, 2005 agreement and Blockbuster's decision to increase its subscription price to match  
12 Netflix, these allegations, of this decreased time lag do not directly respond to the question  
13 whether Blockbuster's decision to increase subscription price was directly caused by  
14 defendants' anticompetitive conduct.

15 In short, plaintiffs' revised allegations may very well target and address each  
16 individual deficiency highlighted by the court previously, and furthermore may go so far as  
17 to plead, in essence, a 'but for' causal link insofar as defendants' conduct and plaintiffs'  
18 injury is concerned (e.g., without Blockbuster's practice of meeting and/or exceeding  
19 Netflix's pricing, Blockbuster would not have sought to raise its \$14.99 price to match  
20 Netflix's \$17.99 price in August 2005). Nonetheless, the court continues to have doubts as  
21 to whether the allegations as a whole set forth a theory that provides a sufficiently direct  
22 link between defendants' allegedly anticompetitive conduct, and plaintiffs' injuries. For  
23 even if plaintiffs have adequately alleged a 'but for' link, it seems to the court that plaintiffs  
24 may have run headlong into the "conceptually more difficult question 'of which persons  
25 have sustained injuries too remote [from an antitrust violation] to give them standing to sue  
26 for damages under § 4.'" Blue Shield of Virginia v. McCready, 457 U.S. 465, 476 (1982).  
27 If, for example, the well-established practice of meeting or surpassing a competitor's price  
28

1 were to give rise to the inference that any price increase undertaken pursuant to such a  
2 practice is directly attributable to the conduct undertaken by competitors for causation  
3 purposes – even when the competitors' conduct is allegedly unlawful – then the court is at  
4 pains to imagine a situation in which a competitor's unlawful conduct *wouldn't* be deemed a  
5 material and direct cause of a co-competitor's price increase for purposes of umbrella  
6 liability standing. As the McCready court noted, although an antitrust violation "may be  
7 expected to cause ripples of harm to flow through the Nation's economy," there is  
8 nonetheless "a point beyond which the wrongdoer should not be held liable." See 457 U.S.  
9 at 477. Query whether plaintiffs are beyond that point here.

10 The court's uneasiness with plaintiffs' revised theory, and its ability to satisfy the  
11 'directness' standard set forth in AGC, is further buttressed by the fact that despite the  
12 court's admonition to plaintiffs in its previous order, plaintiffs have not come forward with  
13 any legal authority to support their theory. The court recognizes the possibility that such  
14 authorities may not exist.

15 Ultimately, however, the court's significant reservations notwithstanding, the court  
16 concludes that plaintiffs' theory of injury is nonetheless sufficiently 'direct' (albeit minimally  
17 direct) to satisfy AGC standards, and to permit plaintiffs to proceed past the pleading stage.  
18 There is, after all, no case law directly on point with the present factual scenario that has  
19 been advanced by either party dictating the court's conclusion. And it is at least possible  
20 that an evidentiary record in the action would permit plaintiffs to flesh out the allegations  
21 currently pled, such that a more direct causal link between defendants' conduct and  
22 plaintiffs' injury might be stated. Discovery may, for example, prove the precise nature of  
23 Blockbuster's pricing in relation to Netflix's, or may demonstrate Blockbuster's awareness  
24 of the purportedly unlawful market agreement well prior to the agreement's public  
25 announcement, as well as the timing and substance of Blockbuster's response thereto –  
26 such that the court could conclude not only that defendants' anticompetitive conduct was  
27 not only the direct cause of Blockbuster's eventual price hike, but also that plaintiffs are  
28

1 within the realm of injured parties for which defendants should justly be held responsible.

2 Likewise, the remaining factors implicating the speculative nature of plaintiffs' injury  
3 and harm, as well as the complexity in apportioning damages, will likely rise or fall upon the  
4 eventual outcome in connection with the 'directness of the injury' factor. Thus, these  
5 factors, too, justify an order allowing plaintiffs' action to go forward at this time.

6 In so ruling, the court emphasizes that it continues to have strong doubts about  
7 plaintiffs' ultimate ability to *prove* the directness of their injury. Nonetheless, the court  
8 would prefer to have a clear evidentiary picture painted before it, in order to ascertain the  
9 actual viability of plaintiffs' claims. At this juncture, however, plaintiffs' revised allegations  
10 and the state of the cited law are simply too uncertain to allow the court to determine with  
11 confidence that plaintiffs have failed to meet the 'plausibility' standard contemplated by  
12 Twombly. See 550 U.S. at 558-59. Accordingly, defendants' motion to dismiss the second  
13 amended complaint is DENIED.

14 The court will permit defendants to file an early summary judgment motion limited to  
15 antitrust standing should discovery result in an evidentiary record which would enable the  
16 court to answer some of the questions raised above. The parties will still be permitted to  
17 file motions for summary judgment at the close of discovery, as provided in the pretrial  
18 order.

19 C. Conclusion

20 For the foregoing reasons, defendants' motion to dismiss the second amended  
21 complaint is DENIED.

22 **IT IS SO ORDERED.**

23 Dated: July 6, 2010



24  
25  
26  
27  
28  
PHYLLIS J. HAMILTON  
United States District Judge